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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

COMMENTS OF LIBERTY MEDIA CORPORATION

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SUMMARY

The rate adjustment methodology ultimately adopted by the Commission in this proceeding will have a direct and substantial effect on the quantity, quality and diversity of the programming available to cable subscribers. Consequently, in addition to providing cable operators with incentives to add new programming and protecting consumers from unreasonable rate levels, an appropriate rate adjustment methodology also should promote the important policy objectives of increased diversity and local origination of programming identified by Congress in the 1992 Cable Act.

Liberty Media supports the Commission's tentative conclusion that the adjusted rate for a modified service tier should not be calculated by multiplying "the benchmark per channel rate based on the new number of channels on the system...by the number of channels on the tier." Third Notice at ¶138. Although simple to administer, this alternative creates a substantial deterrent to the addition of new programming services. Because this alternative is inconsistent with the fundamental policy goals identified by the Commission, it should be rejected.

The Commission's other benchmark-based proposal would decrease this disincentive to adding programming by preserving the prevailing rate for existing services and applying the new per-channel benchmark only to the newly-added services. It also is simple to administer and provides incentives for cable operators to add new services. However, by

capping the per-channel rate applicable to new services, regardless of the actual cost of those services to the cable operator, this approach discourages the addition of new, high-cost programming services and potentially limits program diversity by precluding the introduction of new local and regional news, sports and other higher-cost programming services. However, this serious shortcoming largely can be remedied by adding the Commission's third, cost-based, approach as an alternative methodology.

By incorporating the full cost of new programming services into the adjusted rate, the Commission's third proposal addresses many of Liberty Media's concerns regarding arbitrary disincentives to high-cost programming services. However, by including an "efficiency factor" based on the benchmark tables, the Commission would introduce unnecessary and unfounded complications into the rate adjustment mechanism. Instead, Liberty Media respectfully submits that the Commission should simply add the appropriate per-channel margin to the actual cost of adding the programming.

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COMMENTS OF LIBERTY MEDIA CORPORATION

Liberty Media Corporation ("Liberty Media") submits these comments in response to the Third Notice of Proposed Rulemaking in this proceeding, FCC 93-428, released August 27, 1993 ("Third Notice"). By combining the positive features of two of its proposals, the Commission can advance not only the narrow policy objectives which it has identified, but also broader Congressional objectives at the heart of the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Act").

Preliminary Statement

In its First Report and Order in this proceeding, the Commission "attach[ed] greater importance at this initial stage of rate regulation to assuring the continued growth of programming." Report and Order and Further Notice of Proposed Rulemaking, MM Docket No. 92-266, FCC 93-177 (rel. May 3, 1993) ("Rate Regulation Report and Order"), at ¶251. Again, in this stage of the proceeding, the Commission seeks to "preserve incentives for cable operators to provide additional programming services to subscribers." Third Notice at ¶141. The Commission's alternative proposals represent a thoughtful and genuine attempt to enable cable operators to recover the cost of and to earn a reasonable profit on additional programming services, thereby preserving such incentives.

The Commission tentatively has concluded that the "appropriate methodology" for determining benchmark rate adjustments when channels are added or deleted "should provide sufficient incentives for cable operators to invest in continued growth of cable television service while not permitting operators to raise rates to unreasonable levels." Id. at ¶136. Although Liberty Media does not dispute the validity of these policy objectives, it respectfully submits that the Commission has defined its objectives too narrowly.

The methodology adopted by the Commission will have a direct and substantial impact on future carriage decisions by cable operators and ultimately will affect the quantity, quality and diversity of the programming available to cable subscribers. In addition to the policy goals identified by the Commission, an appropriate rate adjustment methodology also should promote the important policy objectives of increased diversity and local origination of programming identified by Congress in the 1992 Cable Act.

For example, there is little to be gained from providing an incentive for cable operators "to invest in continued growth of cable television service" if such growth does not increase the diversity of programming choices available to consumers, a goal explicitly recognized in the 1992 Cable Act, or promote carriage of those new services that subscribers most demand. See 1992 Cable Act, §2(a)(6), (b)(1), (3). Thus, the appropriate rate adjustment mechanism should ensure that cable operators have an incentive to add new programming services and the services actually added are desired by viewers.

Likewise, the rate adjustment mechanism should account for the "substantial governmental interest" in promoting the local origination of programming. See Id. at §2(a)(10). Many local and regional programming services originate substantial quantities of live local news and sports programming, which makes them more costly than other services. At the very least, the rate adjustment mechanisms adopted by the Commission should not unfairly discriminate against such higher-cost programming services. In short, modification of the Commission's proposals will advance the policy objectives already identified by the Commission, as well as additional objectives identified by Congress.

I. Uniform Application Of New Per-Channel Benchmarks When Adding Channels Would Not Achieve Even The Narrow Objectives Identified By The Commission.

One alternative proposed by the Commission (its "second approach") would adjust the regulated rate for a particular tier to account for the addition or deletion of services on that tier by multiplying "the benchmark per channel rate based on the new number of channels on the system... by the number of channels on the tier." Third Notice at ¶138. In addition to its administrative simplicity,[1] this proposal recognizes that the appropriate rate adjustment mechanism should not affect the rates for regulated tiers other than the tier(s) on which programming services have been added or deleted. Limiting the adjustment to the modified tier is essential to avoid rate changes for the universal basic service tier whenever programming is added or deleted on any other regulated tier.

However, essential elements of this proposal are inconsistent with the Commission's policy objectives. As the Commission has recognized, this methodology "would create substantial disincentives for cable operators with rates above the benchmark to add channels" regardless of the cost of the

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[1] As explained in its Petition for Reconsideration in this proceeding, filed on June 21, 1993 ("Liberty Media Petition"), at 4-14, Liberty Media believes that the Commission's "tier-neutral" benchmark rate mechanism enabling such simplistic administration is inconsistent with the ratemaking criteria set forth in the statute.

new services or the desire of subscribers to receive them. Id. Conversely, this approach "could create undue incentives for systems with below benchmark rates to add channels, permitting substantially increased rates." Id.

However, even if cable rates were at the benchmark level, this alternative does not foster the Commission's objective of "continued growth of cable television service" nor the Congressional objectives of increased diversity and localism. As several petitioners in this proceeding previously have demonstrated, this alternative provides no incentive for systems with existing rates at benchmark levels to add anything but low-cost programming services. See Liberty Media Petition at 21; Petition for Reconsideration of Mountain Cablevision, Inc., filed June 21, 1993, at 2; Petition for Reconsideration of National Cable Television Association, Inc., filed June 21, 1993, at 16-17; Petition for Clarification and Reconsideration of The Disney Channel, filed June 21, 1993, at 14. Thus, for systems with existing rates at benchmark levels, this methodology would discriminate against local news and sports services and other higher-cost programming services, adversely affecting the diversity of programming available to consumers. Consequently, Liberty Media supports the Commission's tentative decision to reject this alternative.

II. The Appropriate Rate Adjustment Mechanism Should Combine Features Of The First And Third Alternatives Identified By The Commission.

As set forth above, the proposed application of the new per-channel benchmark rate uniformly to all services on the affected tier poses a substantial disincentive to additional programming services. The other two alternatives proposed by the Commission partially address this problem. However, by combining elements of both proposals, the Commission can minimize weaknesses in each and promote additional, diverse programming.

A. Application of New Benchmark To Additional Channels.

The Commission's "first approach" would establish a new regulated rate to account for the addition of programming services on a particular tier by: (a) calculating the new per-channel benchmark based on the total number of channels on the system; (b) multiplying that rate by the number of new channels on the tier; and (c) adding that amount to the existing regulated rate. Third Notice at ¶137. This proposal offers "ease of calculation" (id.), with minimal changes in the benchmark methodology, and does not affect the rates of regulated tiers other than the tier on which channels are added or deleted.

By applying the new per-channel benchmark rate only to the newly added services, rather than to all services on the affected tier, this methodology partially addresses the concerns raised by Liberty Media and other petitioners regarding the disincentive to add programming when any additional services reduce the per-channel rate applicable to existing services. Thus, this approach provides at least some incentive for cable operators to add new programming services regardless of the relationship between existing rates and the benchmarks, i.e. whether below, at or above benchmark rates.

However, rigid application of the new per-channel benchmark rate to additional programming services effectively limits the quality and diversity of new programming services carried on the system. By capping the per-channel rate applicable to new services, regardless of the actual cost of those services to the cable operator, this approach discourages the addition of new, high-cost programming services, albeit to a lesser extent than the alternative discussed above. Absent modification, this alternative would limit program diversity by precluding the introduction of new local and regional news, sports and other higher-cost programming services. However, this serious shortcoming largely can be remedied by adding the Commission's third, cost-based, approach as an alternative methodology.

B. Existing Cost/Rate Differential Adjusted By Cost Of Additional Channels And Efficiency Factor.

The third alternative proposed by the Commission would establish the new regulated rate by adjusting the difference between the existing per-channel rate and the corresponding per-channel programming costs to account for new "programming expense" and "to reflect the same proportionate per channel rate increase or decrease observed in the benchmark curve." Third Notice at ¶139. The Commission favors this approach because it would result in new regulated rates which: (a) "maintain their relative position above or below the benchmark, prior to adjustments for external costs;"[2] and (b) "reflect the same efficiencies and economies of scale observed in benchmark rates." Id. at ¶¶139-140.

This proposal would enable cable operators to recover the full cost of new programming services under the

[2] The Commission questions whether the same methodology should be used to set new rates when services are added by "flipping a switch" to activate existing channels as distinguished from facility upgrades that add channel capacity. Third Notice at ¶139 n.248. Although Liberty Media believes that cable operators should be able to recover the cost of system upgrades and rebuilds, and a reasonable return, through a streamlined methodology, such costs should be treated separately from the programming costs for additional channels. Liberty Media also questions whether a program service may be added by simply "flipping a switch." Typically, even where additional channel capacity exists, a cable operator incurs expenses for equipment (e.g. commercial descrambler) and for engineering and administrative services. Further, the cable operator would incur substantial additional promotional expenses to launch the new programming service(s).

new regulated rate. To the extent that this alternative will facilitate carriage decisions based on the merits of the new programming services and not preclude carriage of more costly services based on rigid application of the benchmark tables, it addresses many of Liberty Media's concerns with mechanical applications of the Commission's benchmark-based alternatives.

However, the Commission's proposed adjustment to "reflect the same efficiencies and economies of scale observed in benchmark rates" is problematic. This methodology imposes yet another level of complexity in determining rates. In addition to penalizing operators who have maintained lower-than-benchmark rates in the past, this approach incorporates and extends the arbitrary "efficiency factor" contained in the Commission's benchmark tables.

Application of this "efficiency factor" to the addition of programming services on a regulated tier is inappropriate for several reasons. By referring to the ratio between the existing and the "new" per-channel benchmark rate to determine the new regulated rate when a programming service is added, the Commission essentially is comparing 1994 "apples" to 1992 "oranges." The rate charged in 1992 by a "competitive" cable system for 37 channels of programming should not determine a reasonable rate to be charged in 1994 by a regulated cable operator seeking to increase capacity from 36 to 37 channels and to add a programming service which it did not offer in 1992. Clearly, that same "competitive" operator, when expanding capacity to 37 channels and adding a new programming service in 1994, would not base its rate increase on the 1992 rate charged by another competitive system in 1992 for 37 channels of programming.

Aside from the logical inconsistency of this approach, the ratio of the new benchmark to the old benchmark does not reflect any empirical "efficiency factor," despite the Commission's claims to the contrary. See Third Notice at ¶¶140-142 and n.253. Other measures of efficiency or productivity which the Commission has incorporated into rate regulations applicable to common carriers reflect years of study and comprehensive analyses of costs, efficiencies and savings experienced by the regulated companies. See Policy And Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd. 6786 (1990) at ¶¶74-119, on recon., 6 FCC Rcd. 2637 (1991), aff'd sub nom. Nat'l Rural Telecom. Ass'n v. F.C.C., 988 F.2d 174 (D.C. Cir. 1993). Here, the Commission examined neither costs nor efficiencies in determining the rate benchmarks. Rather, it examined the rates of the surveyed systems at a single point in time and observed a decline in per-channel rates as the number of channels increased. The Commission has no basis for attributing such decrease to savings from efficiencies or economies of scale as distinguished, for example, from bundled pricing strategies or declining programming costs after carriage of certain core programming services.[3] Thus, although the Commission's third proposal addresses many of Liberty Media's concerns regarding arbitrary disincentives to high-cost programming services, the Commission should not further extend its unsupported "efficiency factor."[4]

Because the ease in administering the Commission's "first approach" represents a substantial benefit not only to regulators, but also to cable operators and programmers, that methodology also should be available to cable operators where it permits recovery of their costs and a reasonable profit in providing additional programming services. However, in order to eliminate the disincentive to high-cost programming inherent in the rigid application of such approach, the Commission

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[3] Indeed, the Commission simply noted that:

> Prices per channel decline as the number of channels increases and as the number of subscribers increases. These results are consistent with cable systems having substantial capital costs and overhead expenses that can be spread over more subscribers and over more channels as cable systems expand.

Rate Regulation Report and Order at Appendix E, ¶27. Thus, the Commission did not establish any causal relationship which attributed such decline solely to the claimed efficiencies.

[4] The Commission's proposal also appears to be unnecessarily complex and cumbersome by requiring cable operators to calculate a new average programming cost for all other channels on the affected tier. Further, such averaging may obscure the cost savings from and appropriate rate reductions for future deletions. Liberty Media respectfully submits that the Commission should simply add the appropriate per-channel margin to the actual cost of adding the programming.

should adopt a modified version of its third methodology as an alternative.

Conclusion

Any methodology for pricing additional regulated programming services should allow cable operators to recoup the cost of adding such programming plus an appropriate profit margin. By combining its benchmark and cost-based alternatives, the Commission can develop an approach which would encourage expanded and diverse programming while ensuring that cable operators do not circumvent rate regulation.

Respectfully submitted,

September 30, 1993

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